

AR60

1998 ANNUAL REPORT

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Edmonton, Alberta T6G 2R6



SADDLE

RESOURCES INC.

CORPORATE PROFILE

Saddle Resources Inc. is an emerging junior energy company focused on hydrocarbon exploration and production in Western Canada. The Company's primary area of focus is the Rainbow Lake area of Northern Alberta where the Company currently produces approximately 300 barrels per day of high quality light crude oil. Effective October 20, 1998, all of the shares of Saddle Resources Inc. were acquired by Netalco Corporation and the companies were formally amalgamated on January 1, 1999. The Company has retained the name Saddle Resources Inc. and its shares currently trade on the Alberta Stock Exchange under the symbol "SRI".

ANNUAL GENERAL MEETING

Saddle Resources Inc. invites its shareholders to attend the Annual General and Special Meeting at 9:00 A.M. (Calgary time) on Monday, June 21, 1999 at the Ramada Hotel located at 708 - 8th Ave. S.W., Calgary, Alberta.

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HIGHLIGHTS

	Year ended Dec. 31, 1998	Year ended Dec. 31, 1997	% Change
FINANCIAL			
Revenues	\$ 2,108,978	\$ 364,161	479
Funds from operations	\$ 1,128,378	\$ 249,925	351
Per share	\$ 0.21	\$ 0.09	133
Net earnings (loss)	\$ (3,145,056)	\$ 84,303	
Per share	\$ (0.59)	\$ 0.03	
Capital expenditures	\$ 7,132,828	\$ 1,764,987	304
Working capital surplus (deficiency)	\$ (5,081)	\$ 518,084	
Long term debt	\$ 1,050,000	\$ —	
Common shares outstanding			
Basic	7,735,714	4,800,000	61
Weighted Average	5,369,136	2,669,600	101
OPERATIONS			
Average daily production			
Crude oil and NGL's (Bbls/d)	305	39	682
Natural gas (Mcf/d)	—	—	
Average product prices			
Crude oil (Cdn\$/Bbl)	18.97	25.41	(25)
WTI (US\$/Bbl)	14.42	20.61	(30)
Wells drilled			
Gross	8	3	166
Net	2.8	0.78	259
Success rate (%)	63%	100%	(59)
Reserves - proved and probable			
Crude oil and NGL's (Mstb)	683	244	180
Natural gas (Mmcf)	509	—	
Oil equivalent (Mboe)	734	244	201
NPV @15% (\$000)	\$ 6,235	\$ 3,442	81



REPORT TO SHAREHOLDERS

1998 was a challenging year for the oil and gas industry. Decreased crude oil demand and increasing oil inventories drove crude oil prices to the lowest levels seen since 1986. The WTI benchmark crude prices averaged US\$ 14.42/Bbl compared to 1997 levels of US\$ 20.61/Bbl. Saddle is fortunate that its light crude oil production, which averaged 305 Bbls/day during 1998 at Rainbow Lake, continued to receive superior netback values and generated positive cash flow despite the record low oil prices.

A significant restructuring of the Company occurred on October 20, 1998, when Netalco Corporation acquired all of the shares of Saddle Resources Inc., a private oil and gas company. The companies were formally amalgamated on January 1, 1999, retaining the name Saddle Resources Inc. The Company's shares trade on the Alberta Stock Exchange under the symbol "SRI".

1998 RESULTS AND REVIEW

The drilling results experienced by Saddle during the first half of 1998 were excellent and resulted in a significant increase in the average daily production rate compared to the exit rate in 1997 of 39 Bbls/day. Saddle reached record high levels of approximately 435 Bbls/day during May 1998 as a result of increased production from its new wells. After anticipated natural decline rates, Saddle exited 1998 at approximately 250 Bbls/day. The drilling projects also yielded a number of high graded prospects to be considered for further evaluation.

The drilling results experienced by Saddle during the latter part of 1998 and the first quarter of 1999 were disappointing. Saddle experienced difficulties in the drilling of 5 wells ranging in working interests from 25% to 55%. Saddle is optimistic that 3 of these wells can be successfully recompleted or reworked which will result in commercially viable wells. Remedial work is planned for these wells during the third and fourth quarters of 1999 as surface access conditions permit.

The Company conducted a year end ceiling test using crude oil prices at December 31, 1998 which were US\$ 11.75/Bbl. The disappointing results of our second half drilling operations, combined with the low year end oil price, required a write down of the carrying value of our oil and gas properties by Cdn\$ 4.6 million. This write down is a non-cash charge and does not affect the working capital of the Company.

Saddle's royalty payments remained low in 1998 at an average rate of 8%. This is largely due to Saddle's current royalty holiday status on several wells and its ability to utilize the Alberta Royalty Tax Credit program.

Operating costs were reduced from \$6.10/Bbl in 1997 to \$5.42/Bbl in 1998, and are expected to be further reduced in 1999 as operations are streamlined. General and administrative costs saw a significant reduction from \$2.59/Bbl in 1997 to \$1.59/Bbl in 1999.

Despite the decrease in oil prices experienced throughout the year, Saddle maintained a positive field netback of \$12.04/Bbl compared to \$18.66/Bbl received in 1997.

*Saddle is fortunate
in that its light
crude oil
production
generated superior
netbacks despite
record low oil
prices during 1998.*



OUTLOOK FOR 1999

Management believes that the prudent direction for Saddle during this current cycle of unstable oil prices is to decrease our emphasis on the drilling of new oil wells and increase our concentration on a number of lower cost recompletion and reworking opportunities for both oil and natural gas which we have identified on Saddle owned prospects. In addition, Saddle is proceeding with the tie-in of several wells to nearby facilities which will significantly decrease our operating costs and enhance our netback values. It is our intention to invest our capital on lower risk ventures that will add to our asset base and move forward on exploration and development opportunities when oil prices show strong stabilized improvement.

In order to assist in the financing of our ongoing operations, Saddle/Netalco completed a private placement of flow-through common shares on December 31, 1998 for total gross proceeds of \$1.2 million. These funds will be used to move forward our ongoing oil and gas opportunities in the Rainbow Lake area of Northern Alberta.

Our current inventory of quality oil prospects at Rainbow Lake is increasing and we have several drillable locations which will be further evaluated when oil prices stabilize at levels capable of generating sufficient cash flow to fund additional new drilling projects.

Saddle is also actively evaluating potential property and corporate acquisitions both in the Rainbow Lake area and in other areas within Western Canada which appear prospective for the establishment of additional core areas. We strongly believe there will be a growing number of attractive opportunities available on the merger and acquisitions front throughout 1999.

We are very pleased to announce that on January 18, 1999, Kevin Bibault joined Saddle on a full time basis as Manager, Engineering. Kevin has an extensive background in all aspects of engineering and has proven his ability to add significant value in his prior positions within the industry. Kevin's skills will be extremely valuable to Saddle as we move into a period where we will be emphasizing the exploitation and upgrading of our current asset base.

The patience and loyalty that has been demonstrated by our shareholders during the various stages of our development has been greatly appreciated. The management team at Saddle is committed to improving its efficiencies in finding, developing and producing reserves in order to build a profitable Company and a valuable asset for our shareholders.

We look forward to continuing to update shareholders on our progress and invite shareholders to call us at any time to discuss the progress of your Company.

On Behalf of the Board of Directors

William S. Ward
President

Kenneth L. Broadhurst
Senior Vice President

May 10, 1999

*Our current
inventory of quality
oil prospects at
Rainbow Lake is
increasing and
we have identified
several drillable
locations.*



EXPLORATION REVIEW

Saddle's asset base is entirely situated in the Rainbow area of northern Alberta. Saddle has grown its land and production base from zero to its current levels as a result of in-house full cycle exploration. To date, Saddle has focussed specifically on developing light oil production utilizing 3D seismic and horizontal drilling.

The Rainbow area produces high quality light crude oil from depths of 1,500 to 2,000 metres. The principal oil producing horizon in the Rainbow area is the Keg River formation of Devonian age. The Keg River formation consists predominantly of dolomitized pinnacle, patch reef and fringing reef deposits, as well as bank margin facies. Oil accumulations in patch reef deposits, often limited in size to 160 to 320 acres, have been very prolific. Oil pools of this size can contain recoverable reserves of 10 to 25 million Bbls with individual well productivity of up to 3,000 Bbls/d. The largest oil pool in Rainbow is the Keg River "B" pool which has recoverable reserves in excess of 200 million Bbls. Smaller pinnacle reefs, ranging in size from 40 to 120 acres, have achieved recoverable oil reserves of up to 4 million Bbls with individual well productivity of up to 1,500 Bbls/d. Oil has also been produced from less prolific carbonate bank margin facies in Rainbow; however, these deposits have historically been overlooked due to the huge reserves found in the reef basin. Individual well recoveries from bank deposits are typically in the 100,000 to 300,000 Bbls range; however, recoveries of up to 700,000 Bbls have been recorded. Productivity from these wells is usually around 250 Bbls/d.

Keg River oil exploration is largely seismic oriented. Successful reef exploration involves identification of reef structures and porosity development within such structures. Most of the larger patch reef pools in the Rainbow basin have likely been found; however, the application of 3D seismic surveys along with the improvement of seismic data acquisition, processing and interpretation in recent years, will no doubt result in the discovery of many smaller pinnacle reef pools. Saddle also believes that it can successfully apply its exploration expertise along the bank margin where tremendous potential remains.

The Keg River formation has proven to be a good reservoir for horizontal development drilling. Horizontal drilling can provide access to many pockets of undrained oil which would not otherwise be produced from vertical wells, thereby increasing overall pool recovery. To date, Saddle has focussed on developing a production base by horizontally developing previously discovered oil pools. Saddle's strategy in the Rainbow area is to establish a production base of 500 Bbls/d, utilizing horizontal drilling before dedicating a portion of the budget to explore for new pools.

The Muskeg formation and, to a lesser extent, the Sulphur Point formation, both Devonian in age, have yielded oil and gas production in Rainbow, but again, historically, have not been pursued. Often the Muskeg and Sulphur Point zones are productive when draped over the Keg River reef structures, but each zone can also be productive independent of the Keg River. Examples of this independent Muskeg production show typical individual well oil recovery of 100,000 to 150,000 Bbls, with several wells exceeding 600,000 Bbls. Saddle believes that there are significant opportunities to develop Muskeg oil reserves in Rainbow.

Natural gas is also produced in the Rainbow area. The Cretaceous Bluesky-Gething formation has produced significant volumes of sweet dry gas from depths of 500 metres. Sour wet gas is produced from the Devonian Slave Point and Sulphur Point formations, and occasionally from the Muskeg and Keg River formations. Facility and pipeline infrastructure is very favourable for

*Saddle's asset base
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light oil prone
Rainbow area of
northern Alberta.*



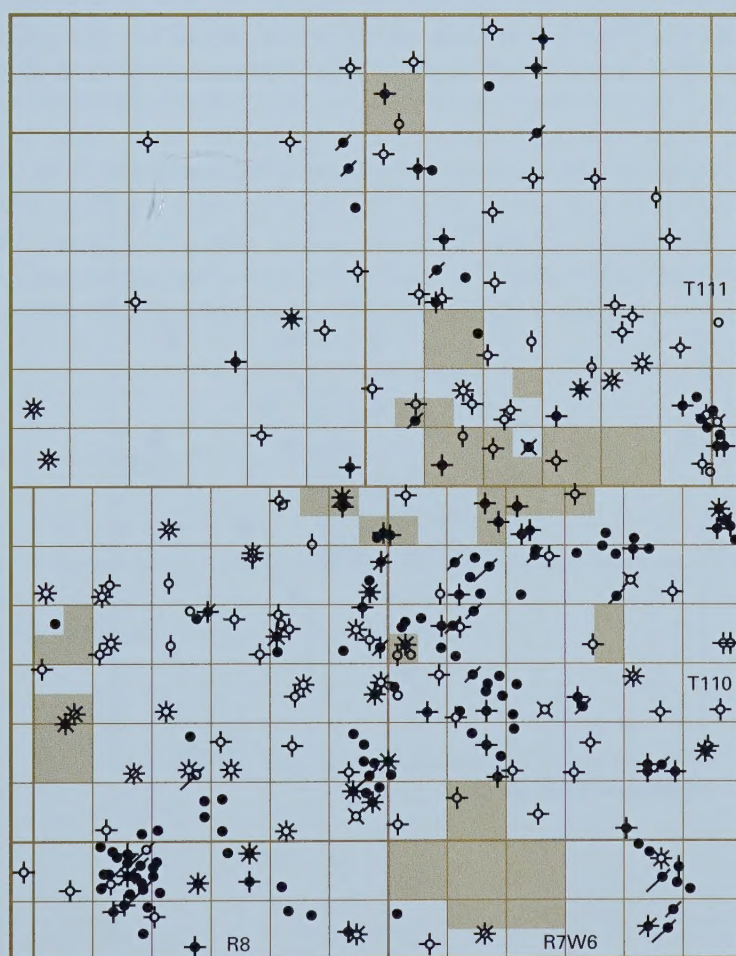
development of gas reserves; however, exploration risk is somewhat high. The best low risk opportunities for developing gas reserves appears to be from bypassed pay identified from older wells. Development of gas production is currently being considered on and around Company lands.

PRINCIPAL PROPERTIES

The Company's properties are all located in the Rainbow area of Northern Alberta. Saddle has broken the Rainbow area down into three geographic blocks designated as Rainbow West, Rainbow East and Rainbow South for internal purposes. At December 31, 1998, the majority of Saddle's oil production was produced from the Rainbow West and Rainbow East areas.

RAINBOW WEST

Saddle has interests in 10,720 (4,773 net) acres in the Rainbow West area for an average 44.5% working interest. At December 31, 1998, Saddle had interests in four producing horizontal oil wells (1.58 net) that were producing at a combined rate of 435 Bbls/d (180 Bbls/d net). Saddle was the operator of all these wells.



Rainbow West Area

*Saddle believes it
can successfully
apply its
exploration
expertise in the
discovery of many
smaller pinnacle
reef pools in the
Rainbow basin and
along the bank
margin where
tremendous
potential remains.*

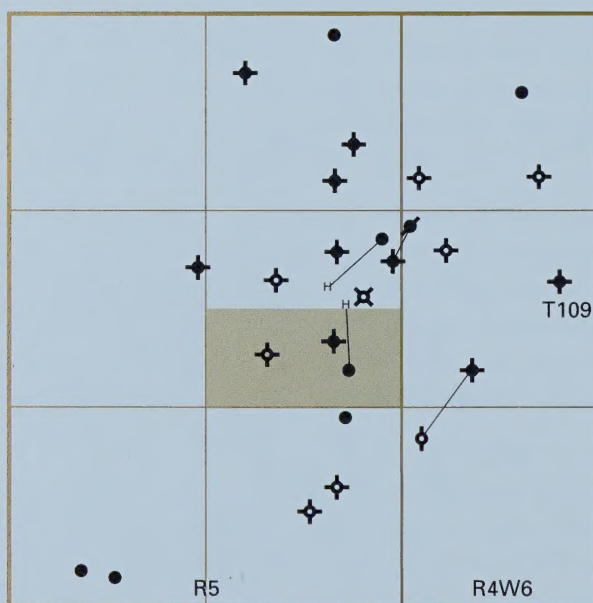


Saddle has generated several prospects in the Rainbow East area and intends to expand its holdings in this area in 1999.

At December 31, 1998 Saddle also had interests in 4 shut-in wells (1.39 net) at Rainbow West. One well, located at 15-7-110-8 W6M, operated by Husky Oil, has been production tested and is expected to be tied in to production facilities in the third quarter of 1999. Saddle has a 35% working interest in this well. Saddle also has a 29% operated working interest in a suspended well located at 11-6-112-7 W6M that was re-completed as a Keg River oil well in the first quarter of 1999. The remaining 2 wells (0.65 net) are suspended horizontal wells that Saddle intends to rework in the third quarter of 1999. In addition to the above operations, Saddle has several horizontal and vertical drilling locations that have been defined by seismic on Company lands.

RAINBOW EAST

Saddle has an interest in 1,120 acres (400 net), and has a drilling commitment in 1999 to earn an additional 640 acres (320 net) in Rainbow East. Saddle has an interest in 1 (0.40 net) horizontal oil well and 1 (0.36 net) vertical oil well that were producing at a combined rate of 160 Bbls/d (60 Bbls/d net) at December 31, 1998. Saddle also has elected on an option to drill a horizontal re-entry well as to a 55% working interest at Rainbow East before December 31, 1999. Saddle and its partner elected to drill the well after interpretation of a 3D seismic survey shot over the lands indicated a favourable Keg River anomaly. The location will offset a horizontal re-entry well drilled in 1998 that has produced at rates of 250 Bbls/d. Saddle has also generated several prospects in the Rainbow East area and hopes to expand its holdings in the area in 1999.



Rainbow East Area

REVIEW OF OPERATIONS

LAND HOLDINGS

At December 31, 1998, Saddle's land holdings were comprised of an interest in over 13,100 acres (6,075 net).

During 1998, Saddle increased its net undeveloped land holdings to 4,695 acres from 1,621 acres in 1997. The increase in net undeveloped acreage resulted from the acquisition of prospective lands at Alberta Crown land sales, farmins on third party acreage, and the acquisition of properties from its joint venture partner at Rainbow Lake.

The land inventory now consists of 4,695 net undeveloped acres (10,250 gross) and 1,380 net developed acres (2,880 gross). Saddle's average working interest in the undeveloped acreage is approximately 45%.

Saddle will continue to high grade land acquisition opportunities on prospective lands throughout 1999.

DRILLING

Saddle participated in the drilling of 8 wells (3.12 net) during 1998, resulting in 5 oil wells (2.74 net) for an overall success rate of 62.5%. All of the wells were drilled at Rainbow. Six of the wells were horizontal development wells, of which 3 were successful oil wells and 3 were dry holes. Two wells were vertical exploration wells that successfully targeted new oil accumulations. Based on budget projections made in early 1999 utilizing a WTI oil price of US\$ 13.50, the Company expects to participate in the drilling of 4 wells in 1999, a decrease of 50% from the number of wells drilled in 1998. Instead, Saddle has identified several recompletions that will be carried out in 1999 in place of drilling. In the event that WTI oil prices stabilize above US\$ 15.00 in 1999, Saddle may drill additional wells.

	Year Ended Dec. 31, 1998		Year Ended Dec. 31, 1997	
	Gross	Net	Gross	Net
Oil	5.0	2.34	3.0	0.78
Dry	3.0	0.78	0.0	0.00
Total	8.0	3.12	3.0	0.78
Success Rate	62.5%		100%	
Average Working Interest	39.0%		26.0%	



*Saddle will
continue to evaluate
land acquisition
opportunities
throughout 1999.*



*Saddle produces a
premium priced,
high quality, light
sweet crude oil
ranging from 38° to
48° API.*

PRODUCTION

Saddle produces a high quality light sweet crude oil ranging in gravity from 38 to 48 degrees API which attracts a top price. Saddle's production stream is weighted 100% to light oil, all of which was produced from the Rainbow area. Saddle produced 111,325 Bbls of oil in 1998 for an average daily production rate of 305 Bbls/d. This represents a 682% increase over 1997 production of 39 Bbls/d.

RESERVES

Saddle's oil and gas reserves were evaluated by Sproule Associates Limited ("Sproule") as at January 1, 1999. The reserve evaluation utilized an average WTI oil price of US\$ 14.50 for 1999. The Company's reserves and future net values at January 1, 1999 are summarized as follows:

Total P&NG Reserves, Mboe*

	Remaining Reserves			Net Present Values			
	Gross	Company		Before income Taxes (M\$)			
		Gross	Net	0%	10%	15%	20%
Proven Developed							
Producing:	760.2	303.9	245.8	4,079	3,106	2,771	2,503
Proven Developed							
Non-producing:	93.0	30.8	23.4	262	239	230	221
Proven Undeveloped:	468.3	148.3	119.1	1,895	1,379	1,203	1,062
Total Proven:	1,321.5	483.0	388.3	6,237	4,724	4,204	3,786
Probable:**	640.3	251.1	193.5	3,289	2,360	2,031	1,762
Total:	1,961.8	734.1	581.8	9,525	7,084	6,235	5,548

* The Company utilizes a conversion factor of 10 Mcf of gas equivalent to 1 Bbl of oil.

** Probable reserves and values were not reduced to account for risk.

MANAGEMENT'S DISCUSSION AND ANALYSIS

SIGNIFICANT TRANSACTION

On October 20, 1998, Netalco Corporation acquired all of the issued and outstanding shares of Saddle Resources Inc., a private oil and gas company. Shareholders of Saddle obtained control of approximately 78% of the total outstanding shares of Netalco and, therefore, the transaction was accounted for as a reverse takeover whereby Saddle was deemed to acquire Netalco for accounting purposes. The transaction provided Saddle with approximately \$1.6 million cash to help fund its capital expenditure program and also provided Saddle with a public vehicle to better access equity markets for future financings.

Effective January 1, 1999, Netalco and Saddle amalgamated under the name of Saddle Resources Inc. In addition, the Company consolidated its share capital on a "5 old for 1 new" basis resulting in 7,735,714 common shares outstanding.

In 1998, production revenues were \$2,108,978, a 479% increase from \$364,181 reported for 1997. This growth is primarily attributable to an increase in crude oil production. As a result of successful drilling activities early in 1998, as well as the acquisition of additional interests in existing properties, crude oil production averaged 305 Bbls/d in 1998 compared with 39 Bbls/d in 1997.

Saddle produces very light oil (38 - 48 degrees API) and therefore receives excellent wellhead prices for its product, generally Edmonton par postings less \$1-\$1.25 per barrel. Overall, however, crude oil prices have decreased substantially from 1997 as a result of the significant drop in world oil prices. WTI oil prices averaged US\$ 14.42 per barrel in 1998, a 30% drop from the average of US\$ 20.61 per barrel in 1997. The Company did not hedge the price of any of its production in 1998 or 1997.

Royalties paid in 1998 were \$166,482 compared with \$9,273 in 1997. This increase is due to increased oil production in 1998. Saddle's low royalty rates of 8% result from royalty holidays on production from certain of its new wells and the Alberta government's royalty tax credit program ("ARTC") which refunded 67% of Saddle's Crown royalties paid in 1998.

Operating costs increased to \$603,065 in 1998 from \$87,509 in 1997. However, on a per barrel basis, costs decreased to \$5.43 from \$6.10 in 1997. The installation of a battery and salt water disposal well at Rainbow East in February contributed to the per barrel decrease in operating costs. The Company is considering the installation of an additional battery at Rainbow West and pipelining in several other wells to third party facilities which will greatly reduce hauling and processing fees in 1999.

Saddle's field netbacks for the years indicated are summarized as follows:

Field Netbacks (\$ per barrel)

	1998	1997
Revenue	18.97	25.41
Royalties	(1.50)	(0.65)
Operating expenses	(5.43)	(6.10)
Field netback	12.04	18.66



*A reverse
take-over of
Saddle by Netalco
Corporation in late
1998 provided
\$1.6 million of
capital and future
access to equity
markets.*



Funds from operations were \$1.1 million or \$0.21 per share, a 351% gain from the previous year.

General and administrative costs increased to \$177,093 in 1998 from \$37,188 in 1997. The increase was due to infrastructure additions (staff, occupancy costs, etc.) to administer expanded operations and additional production. On a per barrel basis, general and administrative costs decreased to \$1.59 per barrel from \$2.59 per in 1997. In 1998, Saddle capitalized \$110,681 of administrative costs directly related to exploration activities. As Saddle is the operator of the majority of its production, the Company receives overhead recoveries from joint interest partners which are accounted for as a reduction in total administrative costs.

In 1998, the Company incurred \$35,563 in interest expense related to bank borrowings to finance its capital expenditure program. The Company borrowed funds at the bank's prime lending rate plus 1%.

Depletion and depreciation rose to \$818,471 or \$7.36 per barrel in 1998 compared with \$133,075 in 1997, which reflects the increased production levels experienced in 1998. In addition, as a result of low year end crude oil prices and unsuccessful drilling activities late in the year, Saddle was required to take a non-cash ceiling test writedown of \$4,600,000, before tax, in the carrying value of its oil and gas properties.

The Company recorded a loss for 1998 of \$3,145,056, or \$0.59 per share, compared to earnings of \$84,000 in 1997. The loss in 1998 is entirely attributable to the writedown in the carrying value of the oil and gas properties. Funds from operations were \$1,128,378 or \$0.21 per share in 1998, a 351% increase from 1997. This increase reflects growth in production volumes at Rainbow Lake in 1998.

LIQUIDITY AND CAPITAL RESOURCES

In 1998, capital expenditures amounted to \$7.2 million, including \$2 million in property acquisitions. These expenditures were financed from the following primary sources:

Cash flow from operations -	\$ 1.1 million
Credit facilities -	\$ 1.1 million
Issuance of common shares -	\$ 2.9 million
Cash acquired on the acquisition of Netalco -	\$ 1.6 million
Working capital -	\$ 0.5 million

The Company has a credit facility with a Canadian chartered bank with a current borrowing base of \$1,500,000. As at December 31, 1998, the Company had borrowed \$1,050,000 under this facility.

The Company is planning a 1999 capital expenditure program of \$1.5 million; however, the impact on cash flow from low oil prices will dictate whether the program will be completed as planned. The Company is required to incur \$1,192,790 of eligible expenditures by December 31, 1999 as a result of the issuance of flow-through common shares.

At December 31, 1998, Saddle has approximately \$7.6 million of tax pools which can be used to shelter taxable income in future years. The following table is an approximate breakdown of Saddle's year-end tax pools.

COGPE	\$ 2,086,000
CDE	3,059,000
CEE	353,000
CCA pools	1,098,000
Loss carryforward	1,005,000
Share issue costs	275,000
	<u>\$ 7,558,000</u>

YEAR 2000

The Company has assessed and continues to assess the impact of the year 2000 issue on its reporting systems and operations. The year 2000 issue exists because many computer systems and applications use two digit data fields to designate a year. In the year 2000 it is anticipated that many of these systems will recognize the year 2000 as 1900 or not at all, and consequently may not function properly.

The Company's significant office information systems have been tested and non-compliant systems are expected to be replaced or modified by June 30, 1999. Field operations have been reviewed and Saddle does not anticipate any effect on these systems as it appears they are not date sensitive.

The Company presently believes that the Year 2000 problem will not pose significant operational problems for the Company's computer systems; however, given the nature of the problem, particularly with respect to third party suppliers and customers, Saddle cannot be certain that all aspects of the problem will be resolved. Expenditures on replacement of or modifications to existing systems is not expected to have a material impact on the operations of the Company.

BUSINESS RISKS

Crude oil and natural gas operations involve certain risks and uncertainties. These include the uncertainty of discovering commercial quantities of new reserves, exposure to volatile commodity prices, fluctuations in foreign exchange and interest rates and the effects of government regulation and taxation.

The Company is continually reviewing means to mitigate these risks. Saddle focuses activities in areas where it believes it has sufficient technical expertise to be successful while maintaining an inventory of prospects. The Company has pursued exploration and development in its core area of Rainbow Lake in northern Alberta, where it has a good understanding of the geological risks and potential. The Company maintains insurance coverage to protect against pollution, well blowouts and other types of unanticipated occurrences that effect the Company's assets. Risks associated with commodity prices, interest and exchange rates are generally beyond the control of the Company; however, as the Company continues to grow it will look at various hedging products that will reduce the volatility in these factors. Environmental and safety risks are addressed by compliance with government regulations as well as adoption and compliance of the Company's safety and environmental standards policy.



MANAGEMENT'S REPORT

The annual report and financial statements have been prepared by management who, where necessary, have made informed judgments and estimates of the outcome of events and transactions, with due consideration given to materiality. Management acknowledges responsibility for the fairness, integrity and objectivity of all information contained in the annual report, including the financial statements.

As a means of fulfilling its responsibility, management relies on the Company's system of internal control. This system has been established to ensure, within reasonable limits, that assets are safeguarded, transactions are properly recorded and executed in accordance with management's authorization and that accounting records provide a solid foundation from which to prepare the financial statements.

The Board of Directors carries out its responsibility for the financial statements principally through its Audit Committee, the majority of which are non-management directors. This committee meets periodically, reviews the scope of the external audit, the adequacy of the system of internal control and the appropriateness of the financial reporting and then makes its recommendations to the Board. Based on those recommendations, the Board of Directors approves the financial statements.



William S. Ward

President and Chief Executive Officer

April 9, 1999

AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheets of Saddle Resources Inc. (formerly Netalco Corporation) as at December 31, 1998 and 1997 and the consolidated statements of operations and retained earnings (deficit) and consolidated statements of cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1998 and 1997 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles.

KPMG-LLP

KPMG LLP
Chartered Accountants

Calgary, Canada
April 9, 1999

CONSOLIDATED BALANCE SHEETS

December 31	1998	1997
ASSETS		
Current assets		
Cash and term deposits	\$ 1,539,576	\$ 1,566,409
Accounts receivable	2,037,557	2,322,594
Prepaid expenses and deposits	58,836	12,437
	3,635,969	3,901,440
Capital assets (note 4)	3,498,351	1,703,653
	\$ 7,134,320	\$ 5,605,093

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities		
Accounts payable and accrued liabilities	\$ 3,641,050	\$ 3,383,356
Bank loan (note 5)	1,050,000	—
Future income taxes (note 7)	—	641,729
Accumulated site restoration and abandonment	32,565	2,225
	4,723,615	4,027,310
Shareholders' equity		
Share capital (note 6)	5,510,551	1,532,573
Retained earnings (deficit)	(3,099,846)	45,210
	2,410,705	1,577,783
	\$ 7,134,320	\$ 5,605,093

See accompanying notes to consolidated financial statements

On behalf of the Board:



William S. Ward
Director



Kenneth L. Broadhurst
Director

CONSOLIDATED STATEMENTS OF OPERATIONS AND RETAINED EARNINGS (DEFICIT)

Years ended December 31	1998	1997
Revenue		
Petroleum and natural gas sales	\$ 2,108,978	\$ 364,161
Royalties, net of Alberta Royalty Tax Credit	(166,482)	(9,273)
Interest	1,603	19,734
	1,944,099	374,622
Expenses		
Operating	603,065	87,509
General and administrative	177,093	37,188
Interest	35,563	—
Depletion, depreciation and amortization	818,471	133,075
Write-down in carrying value of capital assets	4,600,000	—
	6,234,192	257,772
Earnings (loss) before income taxes	(4,290,093)	116,850
Future income taxes (reduction) (note 7)	(1,145,037)	32,547
Net earnings (loss)	(3,145,056)	84,303
Retained earnings (deficit), beginning of year	45,210	(39,093)
Retained earnings (deficit), end of year	\$ (3,099,846)	\$ 45,210

See accompanying notes to consolidated financial statements

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31	1998	1997
Cash provided by (used in):		
OPERATING ACTIVITIES		
Net earnings (loss)	\$ (3,145,056)	\$ 84,303
Add (deduct) non-cash items		
Depletion, depreciation and amortization	818,471	133,075
Write-down in carrying value of capital assets	4,600,000	—
Future income taxes (reduction)	(1,145,037)	32,547
Funds from operations	1,128,378	249,925
Net change in non-cash working capital	(323,451)	227,021
	804,927	476,946
INVESTING ACTIVITIES		
Additions to capital assets	(5,384,828)	(1,764,987)
Notes receivable	(57,500)	—
Net change in non-cash working capital	847,981	820,286
	(4,594,347)	(944,701)
FINANCING ACTIVITIES		
Issuance of common shares, net of issue costs	1,154,937	1,136,771
Net cash acquired on business combination with		
Netalco Corporation (note 3)	1,557,650	—
Increase in bank loan	1,050,000	—
	3,762,587	1,136,771
Increase (decrease) in cash	(26,833)	669,016
Cash and term deposits, beginning of year	1,566,409	897,393
Cash and term deposits, end of year	\$ 1,539,576	\$ 1,566,409

See accompanying notes to consolidated financial statements



NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

On October 20, 1998 Netalco Corporation ("Netalco") acquired all of the issued and outstanding shares of Saddle Resources Inc. ("Saddle"), a private company in the business of exploration, development and production of petroleum and natural gas properties. As explained in note 3, these consolidated financial statements have accounted for the business combination as a reverse takeover and Saddle is considered to have acquired Netalco. Accordingly, these consolidated financial statements reflect the results of operations and changes in financial position of Saddle for periods prior to October 20, 1998. Saddle was incorporated under the laws of the province of Alberta on January 4, 1996.

On January 13, 1999, the Company consolidated its common shares on a 5 to 1 basis. All share and per share amounts in the financial statements reflect the consolidated share structure.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Capital assets:

The Company follows the full cost method of accounting for its petroleum and natural gas operations, whereby all costs relating to the acquisition, exploration and development of petroleum and natural gas reserves are capitalized into cost centres. Such costs include land acquisition costs, geological and geophysical costs, lease rental costs on non-producing properties, costs of drilling both productive and non-productive wells and overhead charges directly related to acquisition, exploration and development activities.

Capitalized costs together with production and related equipment, excluding costs relating to unproven properties, are depleted and depreciated using the unit-of-production method based on estimated proven petroleum and natural gas reserves before royalties as determined by independent petroleum engineers. For purposes of the depletion calculation, gross proven natural gas reserves and production are converted to equivalent volumes of petroleum based on the approximate relative energy content.

The Company applies a "ceiling test" to capitalized costs to ensure that such costs do not exceed future net revenues from estimated production of proven reserves, using prices and costs in effect at the Company's year end, and the costs of unproven properties less impairment. Future net revenues are undiscounted and are calculated after deducting general and administrative costs, financing costs, income taxes and site restoration and abandonment costs. Capitalized costs in excess of this ultimate recoverable amount are charged to earnings.

Proceeds on the disposition of petroleum and natural gas properties are applied against capitalized costs, with gains or losses not ordinarily recognized, unless such a sale would significantly alter the rate of depletion and depreciation.

Depreciation of furniture and office equipment is provided using the declining balance method at rates varying between 20% and 30%.

(b) Interest in joint ventures:

Some of the Company's petroleum and natural gas exploration, development and production activities are conducted jointly with others and, accordingly, the financial statements reflect only the Company's proportionate interest in such activities.

(c) Future site restoration and abandonment costs:

Site restoration and abandonment costs are provided for over the life of the estimated proven reserves on a unit-of-production basis. Costs are estimated each year by management in consultation with the Company's engineers based on current regulations, costs, technology and industry standards. The period charge is included in depletion and depreciation expense and actual site restoration and abandonment expenditures are charged to the accumulated provision account as incurred.

(d) *Measurement uncertainty:*

The amounts recorded for depletion, depreciation and amortization of petroleum and natural gas properties and equipment and the provision for future site restoration and abandonment costs are based on estimates. The ceiling test is based on estimates of proved reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(e) *Income taxes:*

The Company has adopted the liability method of tax allocation accounting. Temporary differences arising from the differences between the tax basis of an asset or liability and the carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse.

An estimate of the future income liability to be incurred on flow-through share arrangements is recognized and charged to share capital at the time the resource expenditure deductions for income tax purposes are renounced to investors.

3. BUSINESS COMBINATION

Effective October 20, 1998, Netalco acquired all of the issued and outstanding common shares of Saddle in exchange for 5,171,504 post-consolidation common shares (25,857,520 pre-consolidation common shares) of Netalco. As the shareholders of Saddle obtained control of approximately 78% of the total issued and outstanding shares of Netalco the share exchange has been recorded as an acquisition of Netalco by Saddle using the purchase method. The acquisition was accounted for as follows:

Allocated:		
Cash and term deposits	\$	1,609,588
Non-cash working capital		28,199
Capital assets		50,000
		1,687,787
Cost of acquisition:		
Share capital issued		1,635,849
Transaction costs		51,938
	\$	1,687,787

4. CAPITAL ASSETS

	1998	1997
Petroleum and natural gas interests	\$ 8,970,170	\$ 1,809,282
Other	48,976	27,036
	9,019,146	1,836,318
Accumulated depletion, depreciation and amortization	(5,520,795)	(132,665)
	\$ 3,498,351	\$ 1,703,653

During 1998, the Company capitalized \$110,681 (1997 - \$69,015) of general and administrative costs related to exploration and development activity.

At December 31, 1998, the depletion calculation excluded unproven properties of \$515,000 (1997 - \$152,856).

As a result of a ceiling test calculation performed with an effective date of December 31, 1998, it was determined that the net book value of the Company's petroleum and natural gas properties exceeded the estimated future net revenues from proved reserves calculated under the full cost accounting guideline and a writedown of \$4,600,000 was recorded as additional depletion. The prices used in the ceiling test calculation were the year end prices for the Company of \$14.73 per barrel of crude oil and \$2.15 per thousand cubic feet of gas. The ceiling test is a cost recovery test and is not intended to result in an estimate of the fair market value.

At December 31, 1998 the estimated future site restoration costs to be accrued over the remaining proved reserves are \$146,173 (1997 - \$26,015).

5. BANK LOAN

The Company has a financing arrangement with a Canadian chartered bank for a \$1,500,000 revolving demand loan with interest payable monthly at the bank's prime rate plus 1% per annum and a \$500,000 non-revolving demand loan repayable monthly with principal plus interest at the bank's prime rate plus 1% per annum. The credit facility is secured by a \$5,000,000 fixed and floating charge debenture over all of the assets of the Company and a general assignment of book debts.

6. SHARE CAPITAL

(a) *Authorized:*

Unlimited number of common shares, without nominal or par value

Unlimited number of preferred shares, without nominal or par value

(b) *Issued:*

	Number of Shares	Amount
Common shares of Saddle		
Balance December 31, 1996	3,300,000	\$ 824,854
Private placement	300,000	180,000
Private placement of flow-through shares	1,200,000	962,000
Income tax effect on flow-through shares		(429,052)
Share issue costs		(5,229)
Balance December 31, 1997	4,800,000	1,532,573
Issued for oil and gas assets	2,000,000	1,748,000
Issued on exercise of stock options	77,000	26,950
	6,877,000	
Common share capital of Netalco		
at time of acquisition ⁽ⁱ⁾	1,475,310	-
Deemed share capital on acquisition of Netalco ⁽ⁱⁱ⁾	5,171,504	1,635,849
Private placement of flow-through shares ⁽ⁱ⁾	1,088,900	1,192,790
Income tax effect on flow-through shares		(532,223)
Share issue costs		
(net of income tax effects of \$28,915)		(35,888)
Balance December 31, 1998	7,735,714	5,568,051
Less note receivable from officers of the Company ⁽ⁱⁱⁱ⁾		(57,500)
	7,735,714	\$ 5,510,551

(i) number of shares have been adjusted to reflect the Company's 5 to 1 share consolidation effective January 13, 1999.

(ii) in 1998, the Company advanced \$57,500 to two officers and directors to acquire shares in the Company. The notes bear interest at 5% per annum, payable at the end of each year, with the principal payable on or before December 31, 2003.

(c) *Flow-through shares:*

In accordance with the terms of the Company's various flow through share offerings, and pursuant to certain provisions of the Income Tax Act, Saddle committed to renounce, for income tax purposes, exploration and development expenditures to the purchasers of its flow through shares in the aggregate amount of \$1,192,790 (1997 - \$962,000). At December 31, 1998 \$1,192,790 of renounced flow through expenditures will be incurred in 1999.

(d) *Stock options and share purchase warrants:*

The directors of the Company have approved stock options whereby common shares of the Company will be available for purchase by directors, officers, employees, and other persons providing services to the Company. At December 31, 1998 options have been granted to purchase 497,333 (1997 - 180,000) common shares of the Company at prices ranging from \$0.46 to \$3.25 per share at various dates to December 17, 2003.

As at December 31, 1998, the Company had 938,643 common share purchase warrants outstanding. The warrants entitle the holder to purchase one additional common share of the Company on or before September 30, 1999 at an exercise price of \$4.75 per common share.

(e) *Net earnings (loss) and funds from operations per share:*

	1998	1997
Net earnings (loss) per share	\$ (0.59)	\$ 0.03
Funds from operations	\$ 0.21	\$ 0.09
Weighted average number of shares outstanding	5,369,136	2,669,600

Earnings (loss) per common share have been calculated using the weighted average number of Netalco common shares plus the additional Netalco common shares issued to acquire Saddle based on the weighted average number of Saddle shares outstanding for each year, after giving effect to the share consolidation. Fully diluted per share amounts are not disclosed as the effect of options and warrants, if exercised, are not dilutive.

7. INCOME TAXES

	1998	1997
Tax expense @ 44.62% of earnings (loss) before tax	\$ (1,914,239)	\$ 52,138
Crown payments not deductible for tax purposes	176,308	15,632
Resource allowance	(124,511)	(14,472)
Alberta Royalty Tax Credit	(117,668)	(20,951)
Unrecognized tax benefits	833,936	—
Other	1,137	—
	\$ (1,145,037)	\$ 32,547

The components of the net future income tax liability at December 31, 1998 and 1997 are as follows:

	1998	1997
Future income tax assets	\$	\$
Non-capital loss carry-forwards	448,680	—
Share issue costs	123,037	—
Tax basis of capital assets in excess of carrying value	835,261	—
Other	(4,016)	—
Valuation allowance	(1,402,962)	—
	—	—
Future income tax liabilities	—	—
Carrying value of capital assets in excess of tax basis	—	641,729
	—	641,729
Net future income tax liability	\$ —	\$ 641,729

8. RELATED PARTY TRANSACTIONS

During 1998, the Company acquired certain oil and gas properties from a joint interest partner, one of the officers and directors of which is also an officer and director of Saddle, through the issuance of 2,000,000 common shares of Saddle and \$3,559 in cash. The value of the transaction was based on independent engineering evaluations. Prior to the effective date of the transaction, the joint interest partner held approximately 4% of the Company's common shares. The joint interest partner participates with the Company in certain oil and natural gas joint ventures on the same terms and conditions as other industry partners. As at December 31, 1998, the Company had a receivable in the amount of \$781,608 from this joint interest partner.

9. COMMITMENTS

The Company has committed to future minimum payments of approximately \$25,000 per year (excluding operating costs) under an operating lease that covers office facilities and expires in 2002.

10. FINANCIAL INSTRUMENTS

The Company's exposure to financial instruments is limited to financial assets and liabilities, all of which are included in these financial statements.

The fair values of financial assets and liabilities that are included in the balance sheet approximate their carrying amounts due to the short-term maturity of those instruments.

Substantially all of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

11. YEAR 2000

The year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the year 2000 issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the year 2000 issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

CORPORATE INFORMATION

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Elk Point Resources Inc.

Matthew J. Brister
President & CEO
Storm Energy Inc.

Kenneth L. Broadhurst
Senior Vice President
Saddle Resources Inc.

Curtis A. Hartzler
President
Birchill Resources Limited

William S. Ward
President and Chief Executive Officer
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